



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778
EMAIL ADDRESS: ASKMAC@AZASRS.GOV • WEB ADDRESS: WWW.AZASRS.GOV

*Paul Matson
Director*

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

**Tuesday, October 19, 2012
8:30 A.M., MST**

The Arizona State Retirement System (ASRS) Board met in the 14th Floor Conference Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Tom Manos, Chair of the ASRS Board, called the meeting to order at 8:33 A.M., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Tom Manos, Chair
Mr. Mike Smarik, Vice-chair
Mr. Tom Connelly
Professor Dennis Hoffman
Mr. Kevin McCarthy
Mr. Brian McNeil
Mr. Jeff Tyne

Two vacant positions.

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the September 21 Public Meeting of the ASRS Board

Motion: Mr. Kevin McCarthy moved to approve the minutes of the September 21, 2012 Public Meeting of the ASRS Board. Mr. Mike Smarik seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

3. Presentation, Discussion and Appropriate Action Regarding the 2013 Legislative Session

Mr. Pat Klein, Assistant Director, External Affairs, and Ms. Lesli Sorensen, Government Relations Officer, addressed the Board regarding the 2013 Legislative Session. During the summer, the External Affairs Division (EAD) received legislative suggestions from ASRS staff concerning plan design issues; plan inefficiencies, inconsistencies, and inequities; administrative concerns; and others. The EAD researched and discussed each suggestion in conjunction with Trustees, Executive Management, and other internal staff.

Ms. Sorensen provided an overview of the following 2013 legislative initiatives the External Affairs Committee (EAC) decided to move forward:

ADMINISTRATION

Federal Conforming Changes

Issue/Suggestion: Adopt the amendment that ASRS Legal Counsel submitted to the Internal Revenue Service (IRS) that was approved by the IRS for continued plan qualification.

Recommendation: Move Forward

Position: Support

Amortization Period

Issue/Suggestion: Permit the ASRS to amortize the past service funding requirement over a period that is determined by the Board and consistent with generally accepted actuarial standards.

Recommendation: Move Forward

Position: Support

Member Identity Security

Issue/Suggestion: Provide a list of member information that is releasable to ensure that member information is protected from potential fraud, abuse or criminal activity, while maintaining transparency to taxpayers.

Recommendation: Move Forward

Position: Support

HEALTH INSURANCE

ASRS Self-insurance

Issue/Suggestion: Permit the ASRS to self-insure a health insurance program if the ASRS determines that self-insuring would be less expensive and at least as effective, while considering the risks and costs, than a fully insured plan. This suggestion would also grant the ASRS the authority to create a separate account to administer the self-insured program.

Recommendation: Move Forward

Position: Support

LONG-TERM DISABILITY PROGRAM

LTD Program Plan Design Changes

Issue/Suggestion: Modify the LTD Program Plan Design for new disabilities as follows:

- Use a 60 month Average Monthly Compensation calculation for determining the LTD benefit.
- Reduce the income replacement level from 66 2/3 % to 60%.

Recommendation: Move Forward

Position: Neutral, since this could be deemed to a benefit modification (albeit only for future disabilities)

PLAN DESIGN

PBI for New Members

Issue/Suggestion: Eliminate the Permanent Benefit Increase program for members whose membership commenced after the General Effective Date.

Recommendation: Move Forward

Position: Neutral, since this could be deemed to a benefit modification (albeit only for future members)

SURVIVOR BENEFITS

Non-Retired Survivor Benefits Redesign

Issue/Suggestion: Simplify the non-retired survivor benefit calculation by eliminating the present value option (currently available to a limited subset of beneficiaries) and limiting the annuity option to a straight-life annuity. (Annuity must still meet the Board's lump sum threshold.) A survivor who elects to take the life annuity will be eligible for the ASRS's Health Insurance program (new), but not the Health Benefit Supplement or potential future PBIs (current).

Recommendation: Move Forward

Position: Support

Mr. Uwe Fink, member of the public, requested to speak regarding potential legislation pertaining to privacy of member information. He explained he is concerned about the dissemination of member information, saying the only information that should be released is name, active/not active, and current/most recent employer. Mr. Fink noted there is currently no provision in the law to ensure a member would be informed if someone requested their information or specifically what information was requested. He does not feel average monthly compensation (except to the IRS), credited service, most recent retirement date, gross pension, or current account balance should be released.

Motion: Mr. Kevin McCarthy moved to approve the 2013 legislative initiatives presented by staff. Support all initiatives with the exception of the LTD Program Plan Design Changes and Eliminating the PBI for New Members, on which the Board should have a "neutral" position, but should provide information to the Legislature on the impact of the initiatives on the Fund. Permit staff to make all language changes and negotiate as necessary to obtain the most effective and efficient legislative provisions within the construct of today's discussion. Professor Dennis Hoffman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

Ms. Sorensen summarized other proposed legislative initiatives not proposed by the ASRS, but that may impact the ASRS

Motion: Mr. Kevin McCarthy moved to oppose legislation to eliminate the Alternate Contribution Rate for pre-July 1, 2011 hires. Mr. Tom Connelly seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

4. Presentation, Discussion, and Appropriate Action Regarding a Potential Change to the Future Interest Accrual Rate Applied to Refunded Member Balances

Mr. Paul Matson, Director, addressed the Board regarding a potential change to the future interest accrual rate applied to refunded member balances. Currently, the accrual rate on member account balances, for the purpose of withdrawal, is 4%. This rate became effective July 1, 2005, following a motion by the Board on August 20, 2004, that lowered the accrual rate from 8%. Mr. Matson noted the External Affairs Committee (EAC) and staff recommend the accrual rate be reduced from the current 4% rate to a rate of 2%. He said there are several reasons for reducing the rate including:

- A 2% rate more closely aligns with the current market interest rates.
- The purpose of the ASRS is to provide a pension, not a future lump sum.
- Reduction in the "optionality value and risk" of two future choices.

- Mitigation of future contribution rate increases.

Motion: Professor Dennis Hoffman moved to approve lowering the interest accrual rate from 4% to 2% as applied to member balances for purposes of withdrawal. Mr. Jeff Tyne seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

5. Presentation, Discussion, and Appropriate Action Regarding Changing the Earnings Rate Used to Calculate Actuarial Present Value for Service Purchase

Mr. Matson addressed the Board regarding changing the earnings rate used to calculate actuarial present value (APV) of service purchase. Members actively contributing to the ASRS, or those currently receiving a Long Term Disability benefit, with a minimum of five years of service credit, are eligible to request to purchase Other Public Service, Leave of Absence Service, and Military Service. Per statute, the cost of the service is equal to the present value of the additional benefit that is derived from the purchased credited service using the actuarial assumptions that are approved by the Board. The current earnings rate used in the assumptions is 8%.

Mr. Matson explained the EAC and staff recommend the Board change the earnings rate used to determine the present value of the purchased service from the "Actuarial Assumed Rate" to the "Actuarial Assumed Rate minus 2%" (from 8% to 6%). He noted there are two reasons for recommending this change. First, the private sector currently sells annuity contracts, which are similar to Service Purchase contracts, with an assumed earnings rate of approximately one-half the rate used by the ASRS. Second, the ASRS Trust fund is not currently compensated for the additional risk of providing the resulting larger pensions. The 2% change in the earnings rate would act as a risk premium.

Motion: Professor Dennis Hoffman moved to approve lowering the earnings rate used to calculate the Actuarial Present Value of service purchase from the "Actuarial Assumed Rate" to the "Actuarial Assumed Rate minus 2%" (from 8% to 6%). Mr. Mike Smarik seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding Outcomes of the ASRS Strategic Plan for Fiscal Years 2010, 2011, and 2012

Mr. Guarino, Deputy Director and Chief Operations Officer, introduced the topic. He summarized some of the top goals of the agency over the last three years: to be a top performer compared to peers, to be more cost efficient, to shift services to the internet, to reinforce good governance practices, and to manage risk proactively.

Ms. Sara Orozco, Strategic Planning Manager, addressed the Board, summarizing the agency's performance against the various expectations outlined in the current Strategic Plan. The time horizon for meeting the goals and objectives outlined in the current plan was set at three years: July 1, 2010 – June 30, 2012.

Ms. Orozco explained the ASRS vision is to be a leading state benefit plan administrator in the areas of:

- Core member services
- Funded status
- Investment performance
- Operational effectiveness

Ms. Orozco noted these strategic aims are to be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity. She said an examination of relevant data demonstrates the ASRS continues to do well meeting the macro-level aspirations outlined in its Vision, providing the following examples:

1. The ASRS continues to meet or exceed most of its established service objectives, with 87 percent of its measured objectives marked as achieved in FY12. Members likewise continue to express overall satisfaction with the service provided by ASRS staff.
2. An international pension administration benchmarking firm has compared the ASRS data to a peer group of comparable size and found the ASRS provides high levels of service at a cost at the median and below the average of its peer group.
3. The ASRS continues to take a leadership role in identifying issues related to ASRS benefits and programs and suggesting possible alternatives for policymakers to consider. ASRS-initiated changes implemented to date are expected to reduce the present value of liabilities between \$5.4 and \$8.5 billion dollars.
4. Constitutional protections are in place to ensure sound actuarial practices are utilized, required contributions are made, and member benefits are protected.
5. The actuarial funded status of the ASRS defined benefit plan is similar to other large public pension plans, at 75.8 percent. According to the Pew Center on the States, the funded status of the ASRS health insurance program is currently higher than any other program in the country. The funded status of the long term disability (LTD) program has gone from zero percent in 1996 to 67.49 percent in 2011, while the contribution rate has fallen, from a high of one percent to 0.48% today.
6. Investment performance has met its long-term benchmark to meet or exceed the actuarial rate of return of 8 percent. When measuring investment performance on an annual basis, the data indicates the ASRS, although currently underfunded, has posted investment returns that met or exceeded 8 percent in 21 of the past 30 years.

Ms. Orozco noted service demand has increased nearly 30 percent since fiscal year 2008 in the disbursement areas, and 13 percent in the member contact areas. Staffing over the five-year period remained relatively flat.

The agency's investment in technology over the last decade has allowed the ASRS to build an operation that provides high service, at a cost that is at or below peers. During the current strategic planning period, web development was a key strategy, which has already delivered results for the agency.

Ms. Orozco discussed a chart depicting how web traffic steadily increased over the three years. She discussed how:

- Visits to the home page and the secure site steadily increased over the 3 years.
- The biggest spikes occurred when major communications were distributed (financial horizons, e-newsletters, member statements) and after major rollouts.
- Midway through the strategic plan, in approximately January 2011, the volume of secure website visits began to eclipse the number of member contacts each month, and have increased each month afterward.

Ms. Orozco highlighted the following key web applications that were rolled out during the three-year period:

1. Online enrollments – the agency moved the entire enrollment process online, which is typically a volume of 30 to 40 thousand pieces of paper per year. The agency used to need 10 or more temporary staff to keep up with volume, which is now no longer needed.
2. Secure email and suppression of remittance advices – in 2010, 83% of total advices generated were mailed. This year, it was only 10%. The yearly savings of this effort is estimated to be \$300,000 or more.
3. Online refunds – 70% of refunds were performed online within the first year. Today – 90%.
4. Planning for retirement webinar and online scheduler – attendance at all meetings is now scheduled online. Members can choose webinar or in-person. Implementation is estimated to reduce call volume by 10,000 or more.
5. Ending Payroll Verification – moves the employer required form for refunds and retirements online. Reduces paper volume by approximately 26,000.
6. E-news – the first version was sent to over 200,000 members last June, with another sent in the last few weeks to over 250,000 members.
7. Member Statements and New Secure Website were rolled out in September, which:
 - Replaced paper version with enhanced website.
 - Allows members to generate a statement with current data at any time.
 - Enhanced content.
 - Saves nearly \$200,000.

Ms. Orozco indicated that the web strategy is already producing results:

- Website usage now eclipses all other member contacts, with the trend of member contacts heading slightly downward.
- Web usage has greatly increased:
 - 39% of retirees are registered.
 - 38% of active members are registered.
 - The use of secure web estimators in FY12 has more than doubled, and the number of custom estimates generated by ASRS staff is declining.

Ms. Orozco explained the ASRS employee survey, conducted in the spring of 2012, indicated employees are generally satisfied with the work environment at the ASRS. She said despite a higher volume of member service requests along with furloughs and decreased pay, employees are more satisfied working at the ASRS since the last employee survey, which was conducted four years ago. She noted employees are proud to work at the ASRS.

7. Presentation, Discussion and Appropriate Action Regarding Suggested Revisions to the ASRS Governance Handbook

Mr. Matson addressed the Board regarding suggested revisions to the ASRS Governance Handbook, summarizing those portions where the revisions were made. Discussion ensued throughout the presentation with Trustees suggesting additional clarifying language be added in a few areas.

Trustees asked questions regarding the Investment Committee Charter, Duties and Responsibilities, and how the Investment Committee (IC) could monitor risk, and the role of the general consultant. A concern is the risk exposure of various managers and whether they are adhering to the standards of the Director's Asset Class Committees, as well as other statutory, policy, and prudence constraints. Mr. Matson said that required some consideration and he would respond at a later time. The topic will be discussed at a future IC meeting.

Motion: Mr. Tom Connelly moved to approve modifications to the ASRS Board Governance Policy Handbook as presented with additional modifications as discussed, and the IC and staff are to review the risk monitoring provisions and reporting requirements and report to the Board at a later date. Professor Dennis Hoffman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 2 vacancies, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding GASB Statement No. 68, Accounting and Financial Reporting for Pensions - an Amendment of GASB Statement No. 27 and GASB Statement No. 67, Financial Reporting for Pension Plans - an Amendment of GASB Statement No. 25

Ms. Nancy Bennett, Chief Financial Officer, addressed the Board regarding the Governmental Accounting Standards Board (GASB) Statements 67 and 68. She noted in January of 2006, the GASB began a re-examination of GASB Statement 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and GASB Statement 27, Accounting for Pensions by State and Local Governmental Employers. The re-examination's purpose was to determine how effective GASB Statements 25 and 27 had been in meeting financial reporting objectives and to determine whether any changes needed to be made. She said the re-examination process resulted in the issuance in June 2012, of GASB Statement 67, Financial Reporting for Pension Plans and GASB Statement 68, Accounting & Financial Reporting for Pensions. Ms. Bennett said these new statements affect only the ASRS 401(a) plan.

Ms. Bennett noted the changes affect the ASRS and ASRS Employers.

Ms. Bennett presented highlights of the new GASB statements:

- Accounting and funding methodologies diverge
- Only one acceptable actuarial cost method for accounting purposes
- Total pension liability determined using fair value of assets for accounting purposes
- Possible blended discount rate for accounting purposes
- Deferred inflows & outflows on employer financials
- Proportionate share of net pension liability on employer financials
- Calculation of pension expense for employers has changed
- Substantial financial statement note disclosures
- Required Supplementary Information new requirement for employer financial statements

Ms. Bennett said GASB 67 and GASB 68 become effective for the June 30, 2014 and June 30, 2015 fiscal year end financial statements, respectively.

Mr. Kevin McCarthy departed the meeting at 11:40 A.M.

9. Presentation, Discussion and Appropriate Action Regarding Moody's Proposed Changes to Pension Data Reporting

Mr. Charlie Chittenden, Actuary, Buck Consultants, addressed the Board regarding Moody's proposed changes to pension data reporting. He explained Moody's Investors Service (Moody's) is proposing to implement several adjustments to pension liability and cost information reported by state and local governments and their pension plans. Mr. Chittenden noted, according to Moody's, the four principal changes under consideration are:

- Multiple-employer cost-sharing plan liabilities will be allocated to specific government employers based on proportionate shares of total plan contributions
- Accrued actuarial liabilities will be adjusted based on a high-grade long-term corporate bond index discount rate (5.5% for 2011 and 2012)
- Asset smoothing will be replaced with reported market or fair value as of the actuarial reporting date
- Annual pension contributions will be adjusted to reflect the foregoing changes as well as a common amortization period

Mr. Chittenden and Ms. Bennett noted the changes will affect employers and because the proposed changes are not consistent with the GASB changes, it could be confusing for employers.

Mr. Chittenden said the following key items with respect to the proposed Moody's methodology are important to note:

1. The actual liabilities payable do not change (increase) based upon the Moody's method, but rather the measured value of the liabilities changes (increases).
2. The Moody's method does not count investment earnings above 5.5%, even when such earnings are expected to be realized.
3. Contribution rates are not expected to approximate those resulting from application of the Moody's methodology, but are rather expected to approximate those estimated using the current actuarial methodology.

10. Presentation, Discussion, and Appropriate Action Regarding Calendar Year 2013 Board Meeting Schedule

Mr. Manos introduced the topic. The Board deferred a decision until the November 16 meeting because one Trustee was no longer present to comment on the proposed calendar.

11. Presentation, Discussion and Appropriate Action Regarding the Director's Report as well as Current Events

Mr. Matson presented the Director's Report. He had no comments and there was no discussion.

12. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Operations Committee Meetings

Mr. Jeff Tyne, Operations Committee (OC) Chair, noted the following topics are to be discussed at upcoming OC meetings:

- a. Administrative Services Division
- b. Financial Services Division
- c. Health insurance contract renewal
- d. Strategic planning

13. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming External Affairs Committee Meetings

Mr. Brian McNeil, External Affairs Committee (EAC) Vice-Chair, noted the following topics are to be discussed at the next EAC meeting:

- a. Update on statewide elections and the effect on legislative initiatives
- b. Update on two rules considered by the Governor's Regulatory Review Council
- c. Privacy disclosure issues relating to public records requests

Ms. Sorensen noted salary spiking initiatives may be discussed for later inclusion in the legislative package. Mr. McNeil noted the next External Affairs Committee Meeting will be held on November 7, 2012.

14. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Investment Committee Meetings

Mr. Tom Connelly, Chair, IC, provided an update on the upcoming IC meeting, saying governance will be discussed. The October 15, 2012 IC Meeting was cancelled and the next meeting will be held in 2013. Mr. Gary Dokes, Chief Investment Officer, noted additional topics to be discussed including strategic asset allocation and securities lending.

15. Board Requests for Agenda Items

Mr. McNeil requested an update on the SB 1609 Defined Contribution and Retirement Study Committee.

16. Call to the Public

No additional requests to speak were made.

17. The next ASRS Board meeting is scheduled for Friday, November 16, 2012, at 8:30 A.M., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

18. Adjournment of the ASRS Board

Mr. Manos adjourned the Board meeting at 12:20 P.M.

ARIZONA STATE RETIREMENT SYSTEM

Lisa Maddox
Board Secretary

Date

Paul Matson
Director

Date